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No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

CITIES OF CHARLOTTESVILLE AND RICHMOND, VIRGINIA,
Cross-Petitioners,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS
OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

On Cross-Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

CROSS-PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a pipeline subject to the Natural Gas Act ("NGA"), enacted to protect consumers of natural gas from unjust and unreasonable pipeline rates, must provide to its customers a full and complete refund ordered by the Federal Energy Regulatory Commission ("FERC") of millions of dollars in rates that were found to be unjust and unreasonable under the NGA, even though that pipeline has filed a petition in bankruptcy.

LIST OF PARTIES AND RULE 29.1 LIST

The caption of the decision below, reprinted in Appendix A to the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit of the Official Committee of Unsecured Creditors of Columbia Gas Transmission Corporation, contains the names of the parties. The Cities of Charlottesville and Richmond, Virginia, own and operate the gas distribution systems serving their respective communities. Neither gas distribution system has a parent or subsidiary company.

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STATUTES

Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* . . . . *passim*

Natural Gas Act, 15 U.S.C. §§ 717 *et seq.* . . . . . *passim*

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CROSS-PETITION FOR A WRIT OF CERTIORARI

The Cities of Charlottesville and Richmond, Virginia ("Cities"), hereby submit their cross petition for a writ of certiorari to review the decision of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit, reprinted in the Official Committee of Unsecured Creditors of Columbia Gas Transmission Corporation's ("Committee") Petition for a Writ of Certiorari ("Committee's Petition"), Appendix A, is reported at 997 F.2d 1039. The order of the United States Court of Appeals for the Third Circuit denying the Committee's Petition for Rehearing is reprinted in Appendix D to the Committee's Petition. The opinion of the United States

District Court for the District of Delaware is not reported, but is reprinted in Appendix B to the Committee's Petition. The opinion of the United States Bankruptcy Court for the District of Delaware, reprinted in Appendix C to the Committee's Petition, is reported at 136 B.R. 930.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The judgment of the United States Court of Appeals for the Third Circuit was entered on July 6, 1993. The order of the United States Court of Appeals for the Third Circuit denying the Committee's Petition for Rehearing was entered on August 6, 1993. The Committee filed its Petition on November 3, 1993. The Cities' Cross-Petition for a Writ of Certiorari ("Cross-Petition") is filed pursuant to Rule 12.3 of the Rules of the Supreme Court.

The Cities received the Committee's petition on November 4, 1993.

STATUTES INVOLVED

1. Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, provides in pertinent part:

> (a) The commencement of a [bankruptcy case] . . . creates an estate. Such an estate is comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case . . . .
>
> (d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

2. Section 4 of the Natural Gas Act ("NGA"), 15 U.S.C. § 717c, provides in pertinent part:

> (a) Just and reasonable rates and charges. All rates and charges made, demanded, or received by any

natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission . . . shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(e) Authority of Commission to hold hearings concerning new schedule of rates. . . . Where increased rates or charges [become effective pending the completion of a hearing], the Commission may, by order, require the natural-gas company . . . to refund any amounts ordered by the Commission . . . .

STATEMENT OF THE CASE

In 1938, Congress passed the Natural Gas Act ("NGA"). 15 U.S.C. §§ 717-717w. The NGA is "plainly designed to protect the consumer interests against exploitation at the hands of private natural gas companies." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 612 (1944). Columbia Gas Transmission Corporation ("Debtor") is a natural gas company subject to extensive regulation under the NGA by FERC. On July 31, 1991, Debtor and its parent, The Columbia Gas System, Inc., filed petitions for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101-1174, in the United States Bankruptcy Court for the District of Delaware.

1. *The Threshold Issue*

The threshold issue presented is whether the ultimate burner-tip consumers that the NGA protects are entitled to a full and complete refund of millions of dollars in payments made pursuant to FERC orders later found to be unlawful under the NGA. These refunds must be flowed through to Debtor's customers in full unless they are considered part of Debtor's estate under Section 541(d) of the Bankruptcy Code. Under Section 541(d), a debtor's property is considered property of the estate "only to the extent of the debtor's legal title to such

property, but not to the extent of any equitable interest in such property that the debtor does not hold." 11 U.S.C. §541(d). Thus, if Debtor has no equitable interest in the refunds at issue here, those refunds are not part of the Debtor's estate, and they must be flowed through to the customers immediately and in full, notwithstanding the priority rights of Debtor's creditors under the Bankruptcy Code.

The Third Circuit carefully analyzed the NGA, the Bankruptcy Code, federal common law principles, and the facts, and held that Debtor did not have equitable title to these refunds and that these refunds therefore are *excluded* from Debtor's bankruptcy estate under Section 541(d) of the Bankruptcy Code. 997 F.2d at 1062. The Cities strongly support the Third Circuit's unequivocal finding that the customer refunds already received and those to be received are excluded from Debtor's bankruptcy estate. *Id.* at 1062. However, the Third Circuit's approach to this issue, which focused primarily on whether a constructive trust had been created for the benefit of Debtor's customers with respect to the refunds, does mean that customers will be deprived of the return of almost $21 million of the approximately $161 million of refunds which the Third Circuit acknowledged they are owed under the NGA. *Id.* at 1053, 1063-64. Consequently, customers will pay rates that exceed the NGA's just and reasonable rate standard.

The reason for this result is that the return of the refunds held in the constructive trust prior to the date on which Debtor filed its petition in bankruptcy is subject to the so-called "lowest intermediate balance rule" which "allows trust beneficiaries to assume that trust funds are withdrawn last from a commingled account." *Id.* at 1063. The Third Circuit held that at the time Debtor filed its bankruptcy petition, Debtor only had $3.3 million in its general account to satisfy the customers' then-existing refund claim of approximately $21 million as well as certain other pre-petition obligations. *Id.* Thus, according to

the Third Circuit, although Debtor's customers are entitled to *all* of the refunds at issue here, they would actually receive only a small share of the pre-petition refunds; the remainder of the pre-petition refunds would simply become unsecured debt. *Id.*

The Committee's Petition seeks review of the Third Circuit's application of federal trust law to the determination of Debtor's interest in the refunds under Section 541(d). The Committee incorrectly contends that state law should apply to this determination, and that under state law, the refunds would be considered part of Debtor's estate and subject to the *pro rata* payment scheme for unsecured debt under the Bankruptcy Code. Committee's Petition at 4-6. According to the Committee, whether state or federal trust law should supply the rule of decision under Section 541(d) is the only issue in this case. *Id.*

Contrary to the Committee's arguments, whether state or federal trust law should apply is not the only, or indeed even the primary, issue in this case. In fact, the threshold question is whether trust law should be applied at all to determine the extent of Debtor's interest in the refunds or whether that determination should be made by analyzing Debtor's interest in the property under the NGA. As Circuit Judge Nygaard explained in his concurring and dissenting opinion (hereinafter referred to as the "partial dissent"), the analysis in this case should have focused on the competing policies behind the NGA and the Bankruptcy Code, rather than on application of trust law:

> The application of the lowest intermediate balance test is both harsh and arbitrary considering the circumstances, and quite simply wrong. . . . Columbia has enough money to pass through all the refunds it received or will receive. The application of the lowest intermediate balance test therefore contravenes the congressional intent behind the Natural Gas Act; under the NGA, these refunds — all of them — belong to the customers, and if Columbia has the ability to

> pay, trust laws notwithstanding, it should be allowed to pay in full.

997 F.2d at 1066-67 (Nygaard, J., concurring and dissenting) (footnote omitted).[1] The Committee either ignored or assumed away this threshold issue and instead focused solely on the secondary issue of whether federal or state law should be utilized to determine whether a trust was established.

Should this Court decide to grant certiorari to the Committee, the issue addressed in the Cities' Cross-Petition — *i.e.*, that under the NGA, Debtor has *no* equitable interest whatsoever in the refunds and that *all* such refunds, both pre- and post-petition, therefore should be returned to Debtor's customers — must also be addressed. If the Court finds that the disposition of the refunds is governed by the NGA in the first instance (*i.e.*, without reference to trust law), the Court need not decide the issue raised in the Committee's Petition.[2]

2. *The Proceedings Below.*

As noted above, Debtor filed a petition for voluntary bankruptcy under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101-1174, on July 31, 1991. Debtor subsequently sought authority from the Bankruptcy Court to pass through to its customers the refunds at issue in this case. The Committee, which is composed of producers that sold gas to Debtor under take-or-pay contracts, opposed Debtor's request, arguing that the customer refunds at issue are part of Debtor's estate under Section 541(d) of the Bankruptcy Code. The Bankruptcy Court,

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[1] In the Third Circuit's order denying rehearing and rehearing en banc, Judge Becker also joined in the views expressed in Judge Nygaard's partial dissent.

[2] The Cities thoroughly refute the Committee's position concerning application of state trust law in their "Brief in Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit" to be filed December 17, 1993, regarding the Committee's Petition.

applying Section 541(d) of the Bankruptcy Code and the federal common law of trusts, found that customer refunds under the NGA were held in trust by Debtor for its customers, were not therefore a part of the Debtor's estate, and thus could be flowed through to Debtor's customers without involving the priority rights of Debtor's creditors. With respect to the approximately $21 million in refunds that were received pre-petition, however, the Bankruptcy Court applied the lowest intermediate balance test, which limited the amount of refunds that could be flowed through to customers to a *pro-rata* share of the $3.3 million in funds that Debtor happened to have on hand at the time the petition was filed.

The United States District Court for the District of Delaware reversed the Bankruptcy Court's finding and, applying state law, held that a trust relationship did *not* exist between Debtor and its customers with respect to the refunds, thus relegating the consumers that the NGA was enacted to protect to the status of unsecured creditors with respect to all of their NGA refunds. The Third Circuit reversed the District Court on both issues, agreeing with the Bankruptcy Court that federal common law should be used to determine whether a trust exists, and that under federal common law, these customer refunds are in fact held in trust by Debtor for the benefit of its customers. However, the Third Circuit also applied the lowest intermediate balance test.

REASONS FOR GRANTING THE CROSS-PETITION

The threshold issue presented for the Court's consideration is whether the NGA alone sufficiently defines Debtor's interest in the refunds for the purpose of determining whether those refunds are part of Debtor's bankruptcy estate or whether it is necessary to apply trust law to determine the extent of Debtor's property interest. *Both* the Third Circuit majority opinion and the partial dissent *agree* that Debtor has no equitable interest in the refunds and that the refunds should be flowed through to

Debtor's customers immediately; however, the majority opinion and the partial dissent reach this conclusion in different ways. This distinction does have a substantive difference; under the majority opinion, consumers receive a substantial portion of their NGA refunds, but not all of them, while under the partial dissent, consumers would receive every dollar of the refunds regardless of whether those refunds were deposited with Debtor pre- or post-petition.

The partial dissent most accurately analyzes the issues in the case by focusing on the goals to be achieved by both the NGA and the Bankruptcy Code, rather than focusing on whether NGA refunds held by the Debtor may be considered to be held in trust for the benefit of Debtor's customers. The partial dissent correctly observes that by focusing on the law of trusts, the Third Circuit majority "bootstrapped itself into applying the 'lowest intermediate balance' test," which resulted in a substantial loss of refunds to Debtor's customers (and the Gas Research Institute). 997 F.2d at, 1066 (Nygaard, J., concurring and dissenting).

The Cities applaud the Third Circuit majority opinion's desire to uphold the consumer protection mandate of the NGA by utilizing the NGA to conclude that the federal common law of trusts must be used to determine Debtor's interest in the refunds. 997 F.2d at 1055-58. However, the partial dissent provides the completely correct analysis of this matter. Stated simply, Debtor has *no* interest in the refunds under the NGA; Debtor therefore has no "equitable interest" in the property under Section 541(d) of the Bankruptcy Code; and customers are therefore entitled to the full and immediate payment of the refunds. 997 F.2d at 1066-67 (Nygaard, J., concurring and dissenting). If the Court grants certiorari to review the Committee's Petition, review of this threshold question — *i.e.*, whether the NGA alone, without reference to trust law, should govern the disposition of the refunds — is necessary because a

decision on this question must precede any decision on the Committee's issue, and a decision in accordance with the partial dissent and the Cities' Cross-Petition would moot the issue raised by the Committee.

1. ***Under The NGA, Debtor Has No Equitable Interest In The Refunds And Debtor's Customers Are Entitled To The Return Of All Refunds Whether Pre- Or Post-Petition.***

Under the NGA, FERC has the authority to review and to modify or change rates that do not meet the just and reasonable standard. 15 U.S.C. § 717c(a). As part of this authority, FERC may allow proposed rates to go into effect subject to refund pending completion of a FERC investigation into the justness and reasonableness of the proposed rates. 15 U.S.C. § 717c(e). The preliminary rates that are allowed to go into effect pending FERC review are *not* final and do *not* meet the statutorily mandated "just and reasonable" standard until (i) FERC issues a final order concerning those rates and (ii) any refunds ordered by FERC of rates previously collected in excess of the just and reasonable level are made to the customers that paid the unlawful rates.

The refunds at issue here result from FERC's attempt to resolve the so-called "take-or-pay" problem through FERC Order Nos. 500 and 528.[3] Pipelines such as Debtor entered into long-term contracts with natural gas producers in the late 1970s and early 1980s that required the pipeline to "take" a certain

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[3] Approximately $161 million of the refunds at issue in this case relate to the take-or-pay claims. Approximately $140 million of these refunds are post-petition, while approximately $21 million are pre-petition. Other categories of refunds at issue in the proceedings below include charges collected by Debtor for the Gas Research Institute ("GRI") and for certain upstream pipelines of Debtor. This Cross-Petition focuses solely on the refunds due to Debtor's customers as a result of the take-or-pay claims.

quantity of gas or to "pay" for that quantity even if it actually took less. As the Third Circuit majority opinion explained:

> By 1987, an oversupply of natural gas significantly decreased market prices, and pipeline customers had little incentive to purchase gas from pipelines at prices sufficient to allow the pipelines to cover the cost of gas they agreed to pay in their take-or-pay contracts. As a result, pipelines' gas sales declined, and the pipelines faced billions of dollars in accrued and future take-or-pay liability.

997 F.2d at 1052.

FERC's initial response to the take-or-pay problem, as set forth in its Order No. 500, was to permit pipelines to buy out or to buy down their take-or-pay contracts and to "equitably" allocate the costs of the buyouts and buydowns among pipelines, producers, and pipeline customers. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 52 Fed. Reg. 39,334, FERC Stats. & Regs. (CCH) ¶ 30,761 (1987) ("Order No. 500"), *remanded, American Gas Ass'n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989). If a pipeline was willing to absorb between twenty-five and fifty percent of these costs, it could "pass through" to its customers an equal portion of the costs via a fixed charge. *Id.* at pp. 30,784-785. The fixed charge to be assessed to each customer of the pipeline was determined by way of the "purchase deficiency methodology," under which each pipeline customer was allocated a portion of these costs based on the decline in that customer's pipeline gas purchases over a relevant period. *Id.* at p. 30,785. In addition, pipelines were also allowed to recover in full from their local distribution company ("LDC") customers (and ultimately from the burner-tip consumers they serve) the take-or-pay costs allocated to them by their upstream pipeline-supplier(s) under the purchase deficiency methodology. *Id.* at p. 30,791. Thus, under Order No. 500, customers such as the Cities were presented a direct

bill for (1) a portion of the take-or-pay costs incurred directly by Debtor and (2) take-or-pay costs assessed to Debtor by its various upstream pipeline-suppliers.

The latter category of costs are at issue in this proceeding. Debtor was billed a certain amount by each of its upstream pipeline-suppliers, which it in turn billed to each of its customers, including the Cities. Each customer paid that amount to Debtor, which simply turned it over to its upstream pipeline-suppliers. Stated differently, Debtor acted as a conduit for payments by its customers to its upstream suppliers, merely passing through dollars paid by Debtor's customers to the upstream pipeline-suppliers and vice versa. As discussed herein, these dollars, to which Debtor has no equitable right, claim, or entitlement, are not part of the property of the estate.

The United States Court of Appeals for the District of Columbia Circuit subsequently struck down the FERC Order No. 500 purchase deficiency allocation method for allocating costs among the customers of a pipeline on the ground that it imposed a retroactive rate increase on those customers in violation of the NGA. *Associated Gas Distributors v. FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 498 U.S. 907 (1990). In response, FERC issued Order No. 528, which required pipelines to file new tariffs that allocate the take-or-pay charges to their customers pursuant to a different allocation method, and to refund the amounts customers were overcharged under the Order No. 500 purchase deficiency allocation method. *See Mechanisms for Passthrough of Pipeline Take-or-Pay Buyout and Buydown Costs*, 53 FERC (CCH) ¶ 61,163 (1990) ("Order No. 528"), *reh'g denied in part, granted in part*, Order No. 528-A, 54 FERC (CCH) ¶ 61,095 (1991), *reh'g denied*, Order No. 528-B, 55 FERC (CCH) ¶ 61,372 (1991).

Pursuant to Order No. 528, five upstream pipelines that supplied gas to Debtor filed new rate schedules; the change in allocation methods used in these schedules resulted in approxi-

mately $161 million in refunds owed to Debtor's customers to compensate for the amounts that those customers were overcharged under the Order No. 500 purchase deficiency method of allocation. Under the terms of Order No. 528 and its FERC Gas Tariff, Debtor again functions as a conduit and is *required* to pass these "take or pay" refunds through to its customers that paid the overcharges to Debtor.

Thus, under FERC Order Nos. 500 and 528, the Debtor is merely a conduit with respect to the take-or-pay costs that are the subject of those orders. When Debtor was presented a bill for these costs by one of its upstream pipeline-suppliers, pursuant to FERC Order No. 500, it simply allocated those costs to its LDC customers, collected them, and turned the proceeds over to the upstream pipelines. Likewise, when the United States Court of Appeals for the District of Columbia Circuit reversed FERC Order No. 500, refunds from the upstream pipeline suppliers were and are to be flowed through by the Debtor to *the LDC customers that paid those costs in the first place*. Under the provisions of the NGA, FERC Order Nos. 500 and 528, and Debtor's FERC Gas Tariff, Debtor had and has *no* equitable claim, title, or interest in either the payments or the refunds.

Hence, Section 541(d) of the Bankruptcy Code does not come into play, and all such refunds, whether pre- or post-petition, should be refunded to Debtor's LDC customers and the consumers they serve. As Judge Nygaard stated in his partial dissent: "it is clear these refunds arise from a federal statute; they were ordered by a federal agency empowered by Congress; they must be passed through to the customers lest the holder violate the law; therefore, *they belong solely to the customers under federal law*." 997 F.2d at 1065-66 (Nygaard, J., concurring and dissenting) (emphasis added).

This conclusion does not undercut the Bankruptcy Code. Had Debtor not declared bankruptcy, then Debtor would have had no equitable right, claim, or title to these refunds. FERC

and its predecessor, the Federal Power Commission ("FPC"), have consistently refused to allow pipelines to assert any claims to retain upstream pipeline-supplier refunds in their possession. *See, e.g.*, Order No. 528, 53 FERC at p. 61,596 ("all refunds must be paid by upstream and downstream pipelines to the customers that actually paid the fixed charges"); *Texas Eastern Trans. Corp.*, 39 FPC 630, 637-38 (1968) (holding that under the NGA "the ultimate consumers of natural gas are proper beneficiaries" of refunds from gas suppliers and that an interstate pipeline "has no legal right thereto"), *aff'd sub nom., Texas Eastern Transmission Corp. v. FPC*, 414 F.2d 344 (5th Cir. 1969), *cert. denied*, 398 U.S. 928 (1970). Since the refunds were ordered to remedy a rate found to be in violation of the NGA, they belong to the customers that paid the unlawful rate in the first place, and accordingly, in the absence of bankruptcy proceedings, would have been paid to those customers in full.

The Bankruptcy Code does not create substantive property rights; it creates a set of procedures for dealing with Debtor's property. *See, e.g., In re Farmers Markets, Inc.*, 792 F.2d 1400 (9th Cir. 1986); *L. King, Collier on Bankruptcy*, ¶ 541.02[1] (15th ed. 1993) ("Section 541 of the Code. . . provides a system for dealing with the debtor's interest in property and his debts. However, the existence and nature of the debtor's interest in property, and of his debts, are determined by nonbankruptcy law.") *See also* 997 F.2d 1066 (Nygaard, J., dissenting and concurring). With respect to the pre-petition refunds, the Third Circuit majority opinion ignores this principle by creating for the Debtor a substantive interest in the pre-petition refunds to the extent that they cannot be returned to Debtor's customers under the lowest intermediate balance test. Stated differently, under the majority opinion, Debtor is permitted to retain almost all of the $21 million in pre-petition refunds that it would otherwise have had to return to its customers under the NGA. This result not only violates the NGA's just and reasonable rate standard, it contravenes the policy behind the Bankruptcy Code

by giving the Debtor a substantive interest in property rights that it would not have otherwise had.

2. *The NGA And The Bankruptcy Code Can Be Harmonized.*

The Third Circuit majority opinion focused first on Section 541(d) of the Bankruptcy Code and analyzed whether the NGA refunds had been held in trust by the Debtor for the benefit of Debtor's customers. The majority apparently did not attempt to determine whether the NGA itself (*i.e.*, without reference to trust law) resolved the issue concerning the extent of Debtor's property interest in the refunds for purposes of applying Section 541(d). While the majority opinion correctly determined that Debtor had no equitable interest in the refunds and that the objective under the NGA is to ensure that "exploited consumers receive the *full* amount of their refunds," 997 F.2d at 1056 (emphasis added), its reliance on trust law rather than the NGA as the basis for its Section 541(d) determination prevented the actual return of the full amount of the refund dollars to Debtor's customers.

The reason for this curious result is that reliance on trust law forced the majority to utilize the lowest intermediate balance test. This problem is easily remedied by recognizing, as the partial dissent did, that Debtor's interest in the refunds can be determined by reference to the NGA alone, without delving into the law of trusts. Thus, because Debtor has no equitable interest in the refunds under the NGA, *all* of the refunds must be returned to the Debtor's customers under Section 541(d).

This analysis is consistent with the precedents of this Court which provide that "[w]hen two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Morton v. Mancari*, 417 U.S. 535, 551 (1974); *see also Connecticut National Bank v. Germain*, 112 S. Ct. 1146, 1149

(1992) ("so long as there is no positive repugnancy between two laws, . . . a court must give effect to both").

Consistent with this rule, the most appropriate approach to the problem — and an approach that gives full play to both the NGA and the Bankruptcy Code — is to determine the extent of the Debtor's interest in the refunds by direct reference to the NGA, rather than by reference to trust law. Thus, as discussed above, Debtor has *no* equitable right, claim, or title to the refunds under the NGA, and under that statute must return those refunds in full to its customers. And, because the Bankruptcy Code simply provides procedures for dividing up a debtor's property and does not create any substantive property rights, the full return of those refunds, whether pre- or post-petition, is fully consistent with Section 541(d). Thus, the analysis presented in the partial dissent harmonizes and gives full force to the policies behind both the NGA and the Bankruptcy Code.

CONCLUSION

If the Court grants the Committee's Petition and agrees to consider whether state or federal trust law should determine the nature of Debtor's property interests in the refunds, the Court should also grant the Cities' Cross-Petition to consider first the threshold question of whether the NGA alone should be utilized to determine the nature of Debtor's interest in the refunds. If the Court finds that Debtor's interest in the refunds is governed by the NGA, and that under the NGA, Debtor has *no* equitable interest in the refunds, there would be no need to decide the issue raised in the Committee's Petition.

The Cities' Cross-Petition for a writ of certiorari should be granted if the Committee's Petition for a writ of certiorari is granted.

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OCTOBER TERM, 1993

OFFICIAL COMMITTEE OF CUSTOMERS OF COLUMBIA GAS TRANSMISSION CORPORATION, PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*, CITIES OF CHARLOTTESVILLE AND RICHMOND, VIRGINIA,
Cross-Petitioners,

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OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

On Cross-Petitions for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION OF CROSS-RESPONDENTS OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION

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QUESTION PRESENTED

Whether the Third Circuit properly required trust claimants to trace the alleged trust funds to property held by the alleged trustee, a debtor in bankruptcy.

LIST OF PARTIES AND RULE 29.1 LIST

The caption of the decision below (Pet. App. 1a-37a) contains the names of the parties.

The Creditors Committee is the exclusive, official body appointed by the United States Trustee pursuant to Section 1102 of the Bankruptcy Code, 11 U.S.C. § 1102, to represent the interests of all of the unsecured creditors of Columbia Gas Transmission Corporation.*

A substantial number of these unsecured creditors are publicly-owned corporations or affiliates or subsidiaries of publicly-owned corporations. According to the Creditors Committee's records, the following are twenty of the largest publicly-owned creditors:

Ashland Exploration, Inc.
(subsidiary of Ashland Oil, Inc.)

Atlas Resources Inc.

Columbia Gas of Ohio Inc.
(subsidiary of The Columbia Gas System, Inc.)

The Columbia Gas System, Inc.

Columbia Natural Resources Inc.
(subsidiary of The Columbia Gas System, Inc.)

Consolidation Coal Co.
(division of E.I. DuPont de Nemours & Co.)

Energy Development Corporation
(subsidiary of Enterprise Diversified Holdings Incorporated, subsidiary of Public Service Enterprise Group Inc.)

Equitable Resources Energy Company
(subsidiary of Equitable Resources, Inc.)

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* The bankruptcy proceedings are currently pending in the United States Bankruptcy Court for the District of Delaware. *See In re Columbia Gas System Inc. and Columbia Gas Transmission Corporation*, Case Nos. 91-803 *et al.* (Bankr. D. Del.).

Exxon Company, U.S.A.
(division of Exxon Corp.)

Kentucky West Virginia Gas Co.
(subsidiary of Equitable Resources, Inc.)

Meridian Oil Production, Inc.
(subsidiary of Burlington Resources, Inc.)

Mountaineer Gas Company
(subsidiary of Allegheny & Western Energy Corp.)

Phillips Petroleum Co.

Phillips Production Co.

Samedan Oil Corporation
(subsidiary of Noble Affiliates, Inc.)

Southeastern Gas Co.
(subsidiary of Northern Engineering Corp., subsidiary of DWG Corp.)

Texas Eastern Transmission Co.
(subsidiary of Texas Eastern, subsidiary of Panhandle Eastern Corp.)

Union Pacific Resources Corporation
(subsidiary of Union Pacific Corp.)

Unocal Exploration Corporation
(subsidiary of Unocal Corp.)

Xplor Corporation

According to the Creditors Committee's records, more than 750 unsecured creditors assert claims of $1 million or more, and more than 2,000 assert claims of $100,000 or more.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

No. 93-876

OFFICIAL COMMITTEE OF CUSTOMERS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Petitioner,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

No. 93-879

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Cross-Petitioners,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

No. 93-904

CITIES OF CHARLOTTESVILLE AND RICHMOND, VIRGINIA,
Cross-Petitioners,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Cross-Respondent.

On Cross-Petitions for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF IN OPPOSITION OF CROSS-RESPONDENT OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-47a) is reported at 997 F.2d 1039. The opinion of the district court (Pet. App. 75a-122a) is not reported. The opinion of the bankruptcy court (Pet. App. 123a-144a) is reported at 136 B.R. 930.

JURISDICTION

The judgment of the court of appeals was entered on July 6, 1993. The order of the court of appeals denying the Creditors Committee's petition for rehearing was entered on August 6, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, provides in pertinent part:

> (a) The commencement of a [bankruptcy] case . . . creates an estate. Such an estate is comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case . . . .
>
> (d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal

title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

STATEMENT OF THE CASE

A detailed statement of the case is set forth in the petition for a writ of certiorari filed on November 3, 1993, and is hereby incorporated by reference. Accordingly, this statement is directed at the issue raised by the cross-petitions. Shortly after filing with the United States Bankruptcy Court for the District of Delaware a petition for voluntary bankruptcy pursuant to Chapter 11 of the Bankruptcy Code, see 11 U.S.C. § 1101 *et seq.*, Columbia Gas Transmission Corporation ("Debtor") sought permission from that court to make preferential payments to its customers in satisfaction of pre-petition refund claims totalling approximately $160 million. The bankruptcy court created new substantive federal common law divorced from any identifiable common law trust principles and granted the Debtor's request. Because commingling of funds by the Debtor precluded specific tracing of the trust funds, however, the bankruptcy court limited the customers' recovery on refunds received prior to bankruptcy to $3.3 million—the amount in the Debtor's general accounts on the petition date.

The United States District Court for the District of Delaware never reached the tracing issue because it reversed the bankruptcy court's decision, properly concluding that no trust existed under applicable state law principles. Pet. App. at 100a-101a. The Third Circuit reversed the district court, holding that newly-created federal common law should govern resolution of the trust issues. *Id.* at 47a. The Third Circuit also agreed with the bankruptcy court, however, that the customers must trace the trust funds to property held by the Debtor and limited recovery on refunds received prior to bankruptcy to $3.3 million. *Id.* at 67a.

REASONS FOR DENYING THE CROSS-PETITIONS

The issue raised by the cross-petitioners—the application of established trust fund tracing principles—does not warrant review by this Court. In urging the Court to consider this issue, cross-petitioners have failed to demonstrate that any of the traditional reasons for granting certiorari exist. The ruling below applying the trust fund tracing requirement does not conflict with any decision of this Court or any other court of appeals. To the contrary, both this Court and the courts of appeals have consistently and uniformly required tracing. Nor does the Third Circuit's straightforward application of the tracing requirement present any issue of general or continuing importance that needs to be decided by this Court.

Indeed, by virtue of their repeated criticisms of the Third Circuit's choice of law analysis, the cross-petitions actually underscore the need for this Court to review the central issue raised in the certiorari petition—that is, identification of the proper body of law to be applied to trust determinations in bankruptcy. Accordingly, review of the issue raised by the petition for writ of certiorari should be granted while review of the tangential issues raised in the cross-petitions should be denied.

1. Cross-petitioners fail to identify any conflict in decision or principle posed by the Third Circuit's routine application of tracing principles. This is because a uniform and well-established body of law exists with respect to the trust fund tracing requirement, a body of law "untainted" by any circuit split or controversy.[1] The courts of appeals

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[1] This Court and the circuit courts have uniformly enunciated the general rule that any party attempting to impress a trust upon funds for the purpose of excluding those funds from the bankruptcy estate bears the burden of sufficiently tracing the trust fund property where such property has been commingled with the general property of the debtor. *See United States* v. *Randall*, 401 U.S. 513 (1971); *Cunningham* v. *Brown*, 265 U.S. 1, 11 (1924); *Schuyler* v. *Littlefield*, 232 U.S. 707, 710 (1914); *First Fed.* v.

have uniformly identified the lowest intermediate balance test as the proper mechanism for implementing the tracing requirement and determining beneficiaries' rights in commingled funds.[2] See *First Fed.* v. *Barrow*, 878 F.2d 912, 916 (6th Cir. 1989); *In re R & T Roofing Structures*, 887 F.2d 981, 987 (9th Cir. 1989); *Connecticut Gen. Life Ins. Co.* v. *Universal Ins. Co.*, 838 F.2d 612, 619 (1st Cir. 1988); *Nation-Wide Check Corp.* v. *Forest Hills Distribs., Inc.*, 692 F.2d 214, 216 (1st Cir. 1982); see also *In re Al Copeland Enters., Inc.*, 991 F.2d 233, 235 n.1 (5th Cir. 1993). This uniform acceptance of the lowest intermediate balance test makes further review of the issue by this Court completely unnecessary and unwarranted.

Indeed, cross-petitioners' argument amounts to no more than a general fairness challenge to the well-entrenched tracing requirement. See, *e.g.*, Committee of Customers' Cross-Pet. at 3. However, the tracing requirement's widespread acceptance is rooted in the careful balance it strikes between the rights of bankruptcy creditors and the rights of trust beneficiaries whose funds are held by the debtor. Tracing principles provide a means of distinguishing trust assets, to which the trust beneficiary can lay priority claim, from non-trust assets, which are the property of the estate and against which the trust beneficiary is in no better position than any general unsecured

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Barrow, 878 F.2d 912, 915 (6th Cir. 1989); *In re Bullion Reserve of N. Am.*, 836 F.2d 1214, 1218 (9th Cir.), *cert. denied*, 486 U.S. 1056 (1988); *Connecticut Gen. Life Ins. Co.* v. *Universal Ins. Co.*, 838 F.2d 612, 618 (1st Cir. 1988); *In re Mahan & Rowsey, Inc.*, 817 F.2d 682, 684-85 (10th Cir. 1987); *Sonnenschein* v. *Reliance Ins. Co.*, 353 F.2d 935, 937-38 (2d Cir. 1965); *American Serv. Co.* v. *Henderson*, 120 F.2d 525, 531 (4th Cir. 1941).

[2] Indeed, given the well-settled requirement that trust property must be clearly identified before it can be distributed, the judicially constructed lowest intermediate balance test challenged by the cross-petitioners actually helps beneficiaries by deeming funds adequately traced that were in fact held in commingled accounts.

creditor.[3] In exchange for this priority of payment accorded to beneficiaries, which represents a departure from the bankruptcy norm of equality of distribution, the law imposes the burden of tracing such trust funds on the party seeking the preferential exception.[4] In this manner, the tracing requirement effectuates the Bankruptcy Code's mandate that trust beneficiaries receive priority distribution only as to *trust* property.[5]

Ultimately the cross-petitioners are simply challenging the application of well-settled law to the facts of this case. The Committee of Customers contends that this Court

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[3] *See, e.g., Gulf Petroleum, S.A.* v. *Collazo*, 316 F.2d 257, 261-62 (1st Cir. 1963) ("with respect to any portion of the fund which cannot be identified or traced into other property [the claimant] must perforce be relegated to proving its claim as a general creditor against the bankrupt estate"); *Haley, Chisholm & Morris, Inc.* v. *Parrish*, 127 B.R. 366, 371 (W.D. Va. 1991) ("[i]f the [trust beneficiary] does not take these steps to facilitate tracing, then he, like his brother the secured creditor who has not recorded his security interest, will be treated, after the initiation of bankruptcy proceedings, no differently than an unsecured creditor").

[4] *See, e.g., In re Bullion Reserve*, 836 F.2d at 1218 (the "tracing requirement is necessary to further the Bankruptcy Code's policy of equal distribution among similarly situated creditors"); *In re Lehigh & N. Eng. Ry.*, 657 F.2d 570, 579 (3d Cir. 1981) (to protect secured and unsecured creditors' interests, beneficiaries of trust funds bear the burden of tracing those funds).

[5] The cross-petitioners' concerns regarding the routine application of trust fund tracing principles are properly addressed to Congress, not the federal courts. Congress has on occasion expressly relaxed the common-law tracing requirement where it has deemed it necessary. *See, e.g., Begier* v. *IRS*, 496 U.S. 53 (1990) (finding clear congressional intent to relax the tracing requirement for tax trusts). Neither the language nor the legislative history of the Natural Gas Act, however, provides any indication that Congress intended to do so with regard to refund claims of gas distribution companies. Moreover, nothing prevents the Federal Energy Regulatory Commission from ordering pipeline companies to segregate trust funds from other funds to facilitate tracing in the event of bankruptcy.

should review the Third Circuit's application of the lowest intermediate balance test to the pre-petition refunds because the Debtor merely acted as a conduit for payment from upstream pipeline companies to downstream customers and because it possessed both the intention and means to replenish the account. Committee of Customers' Cross-Pet. at 3. In essence, cross-petitioners are asking the Court to examine the intricacies of Columbia's role as a conduit as well as its ability and willingness to replenish the funds. The highly factual, case-specific nature of these contentions renders the issue inappropriate for review.

2. The cross-petitions, though failing to merit review in their own right, nonetheless underscore the need to grant certiorari on the real issue in this case—namely, determination of the applicable body of law governing the status and disposition of the disputed funds. Indeed, the Cities' cross-petition formulates the "threshold question" as "whether trust law should be applied at all to determine the extent of Debtor's interest in the refunds . . . ." Cities of Charlottesville and Richmond, Virginia Cross-Pet. at 5. They also apparently agree with petitioners that this Court's review is mandated because the Third Circuit's application of federal common law of trusts undermines the policies underlying the Bankruptcy Code. *Id.* at 13. Similarly, the State Agencies' cross-petition concedes that "[t]he appropriate federal law to be applied is an important question which should be settled by this Court." State Agencies' Joint Cross-Pet. at 9. Although styled as cross-petitions for certiorari on the tracing rule issue, the thrust of the Cities and State Agencies' argument is no different from that urged in the petition. To this extent, petitioners and cross-petitioners are in agreement that the Third Circuit applied the wrong body of law to this case.

The question of what body of law governs trust determinations in bankruptcy clearly is one that needs to be

decided by this Court. The decision below has exacerbated the existing conflict among the circuits with respect to the appropriate scope of federal common law preemption, and thus presents a proper vehicle for resolving that split.

CONCLUSION

The cross-petitions for a writ of certiorari should be denied.

Respectfully submitted,

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